Testimony of Larry Cotter
Before The Honorable Olympia J. Snow, Chair
Sub-Committee on Oceans and Fisheries
United States Senate Committee on Commerce, Science & Transportation

Madam Chair:

I would like to thank you and the members of your committee for inviting me to testify today. I would also like to thank the six CDQ organizations for allowing me to represent them in this hearing. It is an honor and a privilege.

During the past decade, I have been fortunate to witness and participate in the community development quota program from its inception as a concept in the 1980s to its present state today. When the program was first articulated, I was a member of the North Pacific Fishery Management Council. I was present during the deliberations and subsequent adoption of the program. After concluding my tenure on the Council, I assisted the Aleut villages in forming their CDQ organization and establishing their program. Ultimately, I became the Chief Executive Officer of the Aleutian Pribilof Island Community Development Association (APICDA), a position I hold today.

The premise of the CDQ program is that communities and their residents should have a reasonable opportunity to benefit from the use of common property resources adjacent to their geographic location. In the Bering Sea/Aleutian Islands, this was not the case prior to establishment of the program in 1992. Of the 65 eligible CDQ communities immediately adjacent to the Bering Sea and Aleutian Islands in 1991, only two derived any measurable social or economic benefit from the utilization of our fishery resources within our North Pacific EEZ. In the remaining villages and communities, unemployment was chronic and social problems — including substance abuse and suicide — were rampant. The federal and state governments provided a variety of grants and other funding mechanisms to combat these problems, but they could not bridge the gap between the *imposition* of opportunity and the actual *ownership* of opportunity. That is a huge difference.

A decade ago, the BSAI villages and their residents lacked the capital to invest in the industry.

In many cases, the commercial fishing vessels were easily viable operating just offshore, harvesting, processing, reaping the economic benefits of our world class groundfish, halibut and crab fisheries. It is different today.

The CDQ program has enabled western Alaska villages and their residents to directly participate in the commercial fishing industry, either individually or through their CDQ organization. On an annual basis, the CDQ program provides approximately 1,000 jobs for local residents. Over $30 million in wages have been generated, and millions more have been spent providing training and scholarships for vocational and higher education. Both the number of annual jobs and accompanying payroll are increasing each year.

The six CDQ organizations have in excess of $100 million in assets. They serve as owners or joint venture partners in shoreside seafood processing facilities, at-sea catcher processor vessels, large and small shoreside catcher vessels, seafood marketing companies, and a host of other businesses directly related to the commercial fishing industry. In many instances, these investments are located at the village level, where they generate local employment and wages, and stimulate the local economy. To the extent that investments are outside of the village, they generate revenue to the CDQ company for overall use within the program and serve to stabilize the CDQ corporation by diversifying investments. They also provide significant employment and career path opportunities for local residents.

The CDQ program is not race based. The program includes all residents of the eligible villages and communities, regardless of race. This is an important distinction.

The CDQ program is highly regulated. Each CDQ corporation must develop a comprehensive community development plan (CDP) that outlines its entire program for the next several years. Detailed annual budgets must be submitted. Proposed investments must conform to each corporation's investment policies and procedures. Quarterly reports from each corporation, including a progress report on each project and milestone, are submitted. Comprehensive, annual audits of each CDQ corporation are required. The CDQ corporations are prohibited from making investments outside the fishing industry, or ones that do not provide a measurable return to the CDQ communities. Virtually all activities of the CDQ corporations must be approved in one form or another by the state of Alaska and the Secretary of Commerce (acting through the NMFS Regional Director). Any deviation of significance from the CDP or the annual budget must be approved in advance.

The regulations can be troublesome, and have generated friction and concern. A frequent complaint is that the CDQ corporations are hampered by the bureaucracy from acting as normal private sector companies. For example, if a CDQ corporation identifies an excellent investment opportunity at bargain basement prices, it must go through a substantial amendment process requiring approval from both the state and NMFS before it can take advantage of the opportunity — if the proposed investment was not foreseen in advance and included in the community development plan. The amendment process, including the time necessary to develop the accompanying paperwork, frequently requires thirty or more days. By that time, the opportunity may have disappeared because a CDQ corporation cannot commit to the opportunity without prior approval.

Another example is the requirement that any deviation in a budget by more than $100,000 must be approved in advance by the state and NMFS. Since a CDQ "project" includes any investment in which a CDQ corporation owns a controlling interest (50% or more), a major corporation in which a CDQ corporation is an equal owner must foresee in advance all of their budget needs for the next year, or wait for approval from the state and NMFS before spending $100,000 in excess of their approved budget. This presents a major problem since companies cannot see with crystal clarity into the future and must, by competitive necessity, have the ability to operate their business.

The state CDQ team and the six groups have been working this past year to address these and other similar issues. We are hopeful that we can solve these problems. The regulations all relate to oversight of the CDQ program, which reflects the North Pacific Fishery Management Council's original intent that the program be closely monitored to ensure compliance. Unfortunately, the laudable goal of oversight and compliance can conflict with the reality of the business world. A happy medium needs to be identified. Failure to positively address these issues will have a long term negative impact upon the CDQ corporations. Most potential partner companies will not accept CDQ corporations as equal investors because of the impact of the regulations on their ability to be flexible, thereby relegating CDQ corporations to minority owner status. In those cases where a CDQ group, or a combination of CDQ groups, own a controlling interest in a business, the business will operate at a competitive disadvantage until this issue is resolved.

An issue of great significance to at least one of the six groups involves so called "CDQ dollars." When, if ever, does a dollar of CDQ royalty stop being a CDQ dollar? For example, a royalty dollar generated from the lease of pollock CDQ is spent on a business investment within the

scope of the program. Clearly, the royalty dollar was subject to the oversight provisions of the program. But what about the dollar in earnings generated by the business investment, the so called "second generation" dollars? If the dollar is returned to the CDQ group as profit sharing, it is clearly a CDQ dollar again and subject to the program. If the dollar is spent by the business on a new investment instead of returned as profit sharing, is the dollar spent a CDQ dollar? If so, the new investment may be subject to the rules and regulations of the CDQ program. The current definition maintains that second generation dollars are CDQ dollars and subject to the scope of the program.

This issue is particularly important when a CDQ corporation or corporations have a controlling interest in a business investment. If the dollar generated by the business is a CDQ dollar, the business would not be allowed to investment in any entity outside the scope of the CDQ program. The concern by the particular CDQ corporation is that their business investment(s) is not allowed to diversify and strengthen the corporation. In the meantime, the corporation remains subject to the scrutiny and potentially stifling regulations of the program.

The contrary concern is that revenues generated by the CDQ program must be used to the maximum extent possible for the development of stable local economies in the CDQ communities: if second generation CDQ revenues fall outside the scope of the program, there is a fear that they may be spent on investments that provide little or no return at the village level. In such a case, the program itself would be threatened.

Four of the six CDQ corporations support the current definition regarding the use of second generation dollars. One corporation appears undecided. One corporation strongly supports a definition that limits the scope of the program to first generation dollars only, unless second generation dollars are returned to the corporation via profit sharing or another mechanism.

The six CDQ corporations compete against each other for allocations of the CDQ species. The allocation process generates controversy between the six organizations because the amount of the allocation will largely determine (absent returns from investments) the amount of revenue available to each CDQ corporation. Currently, approximately $30 million a year in royalties are generated from the lease of CDQ allocations. The allocation process is managed by the state of Alaska. For the past several years, there has been at least one major allocation each year, although we are now moving to a longer cycle.

In making allocations, the state CDQ oversight team applies a comprehensive list of criteria

when evaluating each CDQ corporation and their allocation request. The criteria — in no order of priority — includes the proposed program, past performance, management expertise, contractual relationships with partners, population, compliance with CDQ rules and regulations, cooperation with other CDQ corporations, the extent to which proposed fishing plans conform with conservation objectives, and other factors. Some of the criteria is based on fact, while some is subjective.

The allocation process is difficult for all involved. Obviously the allocation decisions themselves are subject to praise or ridicule, depending upon what a corporation receives. I do not think anyone is really happy with the process. Some CDQ groups believe they have been unfairly treated in the allocation process, and/or that the allocation process is used as a threat if they fail to adhere to state desires. A few alternatives have been suggested, but none have garnered significant support. It is interesting to note that the North Pacific Fishery Management Council consciously delegated the primary allocation responsibility to the state after contemplating the potential political nightmare associated with making allocations.

To the extent that there is controversy between the CDQ corporations themselves, or the CDQ corporations and the state, they are limited to the scope of regulations, the allocation process, and state oversight. There has been a suggestion that the federal government take over the oversight and allocation responsibilities. This is vigorously opposed by at least four, if not five, of the CDQ organizations. Despite intimations to the contrary, the majority of the CDQ corporations are generally pleased with the job being done by the state and believe the problems that do exist can and will be positively addressed in the near future.

On issues of significance to the Magnuson-Stevens Act, all six organizations have the following comments:

Fees: The last reauthorization of the Magnuson-Stevens Act contained a provision allowing a fee of up to three percent of the value of CDQ allocations to be levied against the CDQ corporation to recover the oversight costs of the state and federal governments. The six organizations have recently reached agreement with the state of Alaska to support state legislation assessing a tax on our corporations to pay for state oversight expenses. We have approached NMFS with the same concept, and hope the Magnuson-Stevens Act will be amended to reflect our proposals.

American Fisheries Act Ownership Side Boards: The North Pacific Fishery Management

Council is currently developing regulations that define which business entities will be subject to AFA side boards. One of the alternatives would include any company, and their affiliates, who own ten percent of more of an AFA processor. Three of the CDQ groups currently own ten percent of more of AFA processors, and two more are contemplating such investment. Inclusion of the CDQ corporations in this rule would have a significant adverse impact on the other investments made by the groups since those investments would then be limited in their harvesting and processing activities by AFA side boards. This appears contrary to the intent of the program (CDQ corporations are to invest and diversify their investments in the industry) and the intent of Congress in providing for $25 million in federal loans (American Fisheries Act) to CDQ corporations to invest in pollock vessels and processors.

We hope that the North Pacific Fishery Management Council will exempt CDQ corporations from these provisions; if not, we would ask that the Magnuson-Stevens Act be amended to address our concerns.

Federal Loan Funds: As mentioned above, the American Fisheries Act set aside $25 million for loans to assist CDQ corporations to acquire ownership in AFA vessels and processors. We would like the program extended and expanded to include other fisheries. This would be of great benefit to us.

On other issues of importance, we have encountered continuous difficulty with the National Marine Fisheries Service regarding observer requirements for CDQ fisheries. The NMFS requires that there be two observers on all catcher processor vessels, regardless of size. The observers must be specially trained. The same rules have now been extended to all AFA vessels participating in co-ops. There are simply not enough trained observers to meet our individual CDQ or collective CDQ and AFA needs. This past summer many of the CDQ corporations experienced significant problems locating observers so they could harvest their CDQ. One CDQ group went 45 days without locating the necessary observers. Without the required observers we are not allowed to fish. To the extent that the NMFS has indicated flexibility in this rule, the flexibility provided limits the fishing time so that it is not economically feasible to fish.

The NMFS has not been responsive to our problems in this area. It is a major problem.

Another concern with observers is the variance between the observed catch as defined by the observer and the back calculated catch as defined by the products produced on board the

vessel using NMFS product recovery rates. The variance in Pacific cod CDQ fishing, for example, has ranged as high as twenty percent or more, with the observer nearly always showing a higher number. We strongly support accurate accounting of catch, but we are not convinced that the current approach accomplishes the goal given the variance. For pacific cod, all six CDQ groups have proposed to the NMFS that we implement an alternative system that would include using the observer to count fish that drop off before coming aboard and using product recovery rates (constantly monitored to ensure they are accurate) to determine the landed weight.

Although the NMFS regulations allow for an alternate method of catch accounting, the resistance to the change, or time restraints, have resulted in an unwillingness to move forward to address this problem. In the meantime, we do not know if we are over harvesting or under harvesting. This has both biological and economic ramifications. The problem is not limited to cod. It needs to be resolved.

A final issue that concerns us is the exactness required by the regulations in terms of harvesting our CDQ allocations. We are prohibited from exceeding any allocation. In some cases, our allocations are several thousand tons, in other cases only 4 tons. Fishing is not an exact science. There will be tows or sets where the catch is greater or less than desired or sought. The CDQ groups have proposed that the collective allocations serve as the cap, and if an individual group exceeds their allocation for a particular species they will not be penalized if they can secure additional fish from another CDQ organization before the end of the year to cover their overage. Again, due to time restraints this issue has not been resolved.

Despite the problems identified in this testimony, the CDQ program has worked wonderfully. In seven years, the CDQ corporations have evolved and grown from nothing to fairly significant corporations. There has been a great return to the villages and their residents. They have ownership in the industry and they participate in the industry. They have a future in the industry, and they have goals and objectives as individuals and communities relative to the industry. None of this would have been possible with the CDQ program.

Thank you again for providing me with the opportunity to testify today.